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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

314-64

No. 219

SAMUEL NEWFIELD, TRUSTEE OF THE 671 PROSPECT AVENUE HOLDING CORPORATION, *Petitioner*,

vs.

EAST RIVER SAVINGS BANK.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

W. CAMERON BURTON,
MAX ROCKMORE,
Counsel for Petitioner.

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EAST RIVER SAVINGS BANK.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

Petitioner, Samuel Newfield, as trustee of the 671 Prospect Avenue Holding Corporation, Bankrupt, prays that a Writ of Certiorari issue to review the decree of the Circuit Court of Appeals for the Second Circuit, entered in the above proceeding on the 10th day of April, 1941, affirming an order of the District Court for the Southern District of New York, which reversed an order of the referee who overruled the objections of the respondent to the jurisdiction of the referee to summarily determine the value of chattels which were taken from the possession of the trustee by a receiver appointed by the Supreme Court of the State

of New York in an action brought by respondent to foreclose its realty mortgage. The affirmance by the Circuit Court of Appeals was without prejudice to proceedings to recover possession of the chattels or the proceeds of their sale, or to a plenary suit to recover damages for using or converting them.

The opinion of the Circuit Court of Appeals is printed at page 33 of the printed record and is reported in 118 F. 2d 455.

Jurisdiction.

1. The jurisdiction of this Court is invoked under Section 240, Subdivision (a) of the Judicial Code, as amended by the Act of February 13, 1925, C. 229, Section 1, 43 Stat. 938; 28 U. S. C. A., Sec. 347 (a).

2. The decree of the Circuit Court of Appeals sought to be reviewed is dated April 10, 1941 (R. 37). Said decree affirms the order of the District Court in favor of the respondent here.

Statute Involved.

Section 23 of the Bankruptcy Act, 11 U. S. C. A. 46.

Summary Statement of the Matter Involved.

The bankrupt owned and operated a building at 671 Prospect Avenue, Bronx Borough, New York, for catering purposes. The building was equipped with the necessary fixtures, furniture and kitchen utensils adapted to that type of business. The building was subject to a mortgage held by the bank for $116,500, which the bank claimed covered both the realty and the personalty.

After the petitioner's election as trustee (he having theretofore taken possession of the building and its contents as bankruptcy receiver) he moved in the District Court for an order to limit the scope of the bank's mortgage lien to the realty. The bank filed an answer to that petition, asserting

that the mortgage gave it a lien on the personalty as well; and after a trial which tested that question the referee decided in petitioner's favor and held that the mortgage covered the real property only. The bank successfully reviewed the order which followed and an appeal by petitioner resulted in an affirmance. 97 F. (2d) 513.

Sometime later the court's decision was vacated, the mandate recalled and the appeal restored for reargument. That resulted in a reversal of the District Court's order which had in turn reversed the referee's order and the Court held, as did the referee, that the mortgage created a lien in the bank's favor over the realty alone and did not affect the bankrupt's chattels which were located in the building. 105 F. (2d) 960.

Before this question was raised or determined, however, petitioner went into, took and remained in possession of the building and its contents until the bank moved in the District Court for leave to foreclose its mortgage. That motion was granted and an action was brought in the New York Supreme Court, petitioner being made a party thereto. The bank moved in that Court for the appointment of a receiver in foreclosure and notwithstanding petitioner's resistance thereto the application was granted and Francis L. Valente was appointed receiver. He took from petitioner possession of the building and its contents and collected the rents for both building and chattels from November, 1937, to July, 1938, for which he accounted to the bank as mortgagee. The mortgage suit continued in the State Court after the decision of the Circuit Court of Appeals on the first appeal and the bank took title to the premises and its contents upon sale in foreclosure. The receiver continued to collect the rents from the building and for the use of the chattels until the bank sold the building and its contents to one Infeld, to whom it gave title to both, and Infeld is now in sole possession thereof.

Subsequent to the second decision of the Circuit Court of Appeals as reported in 105 F. (2d) 960, petitioner moved in the District Court to fix the damages sustained by him as a result of the improper assertion of title to and possession of the chattels by the bank. On that application the bank appeared and submitted an answer in opposition, *which did not challenge the jurisdiction of the Bankruptcy Court,* but merely asserted among other things that one Gussie Hutt, the holder of an alleged mortgage on the same chattels, had rights superior to those of petitioner, and on the strength of that statement District Judge Coxe denied the motion "without prejudice to a motion before the referee for relief against the bank or anyone else or a plenary action" (R. 8).

It then became necessary for petitioner to clear the title to the assets, and to that end he brought suit in the District Court against the bankrupt, against Chateau De Luxe, Inc., an alleged assignee of the chattels, and against Mrs. Hutt the alleged mortgagee, to set aside both the transfer and the mortgage. That trial resulted in a judgment for petitioner, so that at the time the instant application came before the District Court petitioner had complete and absolute unencumbered title to the chattels.

Throughout the course of these proceedings and for a period of over three years the chattels, which were always assets of the bankrupt estate, were taken over and appropriated by the bank, which collected the rents from their use and the avails of their sale.

The present application was thereupon made to the District Court to recover not only the value of the chattels unlawfully appropriated by the bank, but the value of their use while the bank was in possession thereof and for which it had received rents. Notwithstanding the bank's repeated appearances throughout the various controversies preced-

ing that application, the bank for the first time on this motion raised the question of the referee's power to summarily determine this controversy. It claimed that the District Court did not have summary power to fix the loss it had itself brought about by its unwarranted taking of assets which belonged to the petitioner and that petitioner was bound to seek his relief in a different forum.

The Referee in overruling the Bank's objection said (R. 16):

> "* * * I am going to determine that this Court has jurisdiction; that by the decisions of the various courts the title to this property was vested in the trustee from the inception of this bankruptcy; and that, therefore, this Court has the right in a peremptory summary fashion to pass upon the question of what damage, if any, has been sustained by this trustee by virtue of any acts that they may be able to prove that the bank violated the trustee's rights in the use of this property."

From the order which followed, the bank took a review in the District Court where the referee's order was reversed, Judge Knox holding that upon the authority of *In re Reading Engineering, Inc.*, 29 F. (2d) 22, the damages could not summarily be ascertained in the bankruptcy court.

From the decision of the Circuit Court of Appeals affirming said order without prejudice to other summary proceedings to recover possession of the chattels or proceeds of sale of them, or to a plenary suit to recover damages for using or for converting them, this application is made.

Specification of Errors.

The Circuit Court of Appeals erred in holding that the trustee's only remedy to recover the value of the chattels unlawfully taken after bankruptcy intervened was by a plenary action. That is the question here to be decided.

The chattels having been in the custody of the bankruptcy court which had exclusive control over them and over the controversy respecting them, that court was empowered under familiar legal and equitable principles to render a complete determination respecting them unless the Bankruptcy Act declares otherwise. The bankruptcy court has exclusive possession of all the property of the bankrupt upon the filing of the petition in bankruptcy. *Page* v. *Edmunds,* 187 U. S. 596, 23 S. Ct. 200, 47 L. Ed. 318. The court also has summary jurisdiction to recover property of the trustee unlawfully taken from him. *White* v. *Schloerb,* 178 U. S. 542, 20 S. Ct. 1007, 44 L. Ed. 1138; also where the property is in the custody of a person who does not claim it. *Babbit* v. *Dutcher,* 216 U. S. 102, 30 S. Ct. 372, 54 L. Ed. 402; and of property held by one who does claim it but whose claim is so insubstantial in fact or law or both that it is only colorable, *May* v. *Henderson,* 268 U. S. 111, 116, 45 S. Ct. 456, 69 L. Ed. 870. So, also is the ruling in the case of *In re Quan Weing,* 2 Cir., 104 F. (2d) 113, where the court said that power undoubtedly rests in Congress to provide for summary Federal jurisdiction to determine the right of a trustee in bankruptcy to recover property adversely claimed.

In the instant case the East River Savings Bank never claimed title to the chattels; the Circuit Court of Appeals in its earlier decision, 105 F. (2d) 960, held that its mortgage created a lien on the realty alone and did not affect the chattels which were located in the building. Before that decision was rendered, however, it went into possession, took, used and later sold the chattels.

In the case of *In re Rose Shoe Mfg. Co.,* 2 Cir., 168 Fed. 39, it appeared that the respondent, a bank creditor secured by accounts receivable of the bankrupt, took possession of a quantity of shoes which were returned to and were in the

hands of the bankrupt after the petition was filed, and sold them. The trustee moved for an order to direct the bank to pay over what it had collected from the sale, and in sustaining the referee's order granting the application, the court said:

> "Nor does the fact that the bank sold the shoes change the situation. The proceeds stood in their place. The court had power to direct the turning over of such proceeds to the trustee. In First National Bank *v.* Chicago Title & Trust Co., 198 U. S. 280, 25 S. Ct. 693, 49 L. Ed. 1053, the Supreme Court said:
>
> 'The sale in the circumstances did not change the situation. The proceeds stood in the place of the property, and the order returning the proceeds was equivalent to an order returning the property.' "

A summary proceedings to recover the proceeds would be of little avail to this petitioner since the property was sold privately by the bank and the amount received was far below the actual market value as alleged in the trustee's petition (R. 9).

It is respectfully requested that this petition be granted on the basis of Rule 38, subd. 5(b) of the Revised Rules of this Court. There exists a conflict with the decisions of other circuits on the same subject as well as with a prior decision of the same court.

In the case of *Commercial Casualty Insurance Co.* v. *Williams*, 4 Cir., 49 F. (2d) 472, the Circuit Court of Appeals said:

> "This case was before this court on question of ownership of the property here in controversy. Commercial Casualty Ins. Co. *v.* Williams, 37 F. (2d) 326. This court affirmed the decision of the judge below, holding that the property in question belonged to trustee, and reference was had to a referee to take evidence *as to the value of the property* used by appellant in the

completion of the building, under the circumstances detailed in the former decision of this court above cited, and report to the District Court. Evidence was taken, and referee reported in detail *as to the value of the property*, fixing the total sum at $20,191.11. * * * * * * Here, an examination of the record convinces us that the report of the referee was clearly right. Appellant took the property wrongfully, and certainly cannot be allowed to profit by its wrong. In re Schilling, et al. (D. C.) 264 Fed. 357, and authorities there cited."

So also did it appear in the case of *In re Denson*, 195 Fed. 854 decided in the District Court for Northern Alabama wherein a fraudulent transfer was made after bankruptcy. The court said (P. 855):

"The inquiry which requires consideration is whether a summary petition in a bankruptcy cause or a plenary suit was the appropriate proceeding * * * "

And on pages 856, 857:

"* * * The petitioner, by mingling the goods with his own stock and selling part of them, had by his own act made restoration in kind impossible. The referee required him to restore the value of the goods, as invoiced, instead of the price the petitioner paid the bankrupt for them, which was 50 per cent of that amount. The amount required to be restored should represent the actual value of the goods when taken over by petitioner. The evidence as to its value is conflicting * * *

"In view of these undisputed facts and of the circumstances of extremity of the bankrupt known to the petitioner when he made the purchase, I am persuaded that they were bought by him at a sacrifice from the true value; and that the amount fixed by the referee represents the true value of the goods at the time of their receipt by petitioners."

Judge Swan in his opinion in the instant case states:

> "The appellant relies on May *v.* Henderson, 268 U. S. 111, 45 S. Ct. 456, 69 L. Ed. 870. It is true that at page 119 of 286 U. S., at page 460 of 45 St. Ct., 69 L. Ed. 870, it was said that one subject to a turn-over order to restore property to the bankrupt's estate, 'if he has sold it,' may be compelled by summary order to restore the value of the property thus wrongfully diverted. But we did not in the Reading case read this as meaning that a summary action will lie for damages for conversion of property in possession of the trustee in bankruptcy; nor do we now."

Petitioner respectfully submits that he is not seeking "damages for unlawful conversion of the chattels", as the Circuit Court of Appeals said in its opinion; but, relying upon rulings of this Court in the case of *May* v. *Henderson, supra,* and of the courts of other jurisdictions in the cases heretofore cited, he is seeking the substitute for the *res* or its reasonable value when taken by the bank, the *res* having been privately sold by the bank after possession thereof was obtained by it subsequent to the filing of the petition in bankruptcy. Nor would the situation be changed even though the act of the bank could be called a conversion because in the last analysis, it was the loss sustained by the bankruptcy estate as a result of the bank's unwarranted appropriation, use and sale of those chattels which petitioner is seeking. The bank at no time asserted title, its only claim being that it had a lien by virtue of its mortgage. That was however dispelled by the decision of the Circuit Court of Appeals on the appeal reported in 105 F. (2d) 960.

The Circuit Court of Appeals relied upon its own prior decision in the case of *In re Reading Engineering Inc.*, 29 F. (2d) 22, where it held that the trustee could summarily recover possession of such specific property of the bank-

rupt as was still on the appellant's land, and "in a proper proceeding" could recover the value of such property as the appellant had converted. In the decision from which this review is sought, the court said that a "proper proceeding" meant a plenary suit. The cases can be distinguished. In the first place, although the opinion in the *Reading* case does not so state, the respondent in the court below, who was the appellant in the Circuit Court, made a preliminary objection to the jurisdiction of the bankruptcy court to determine the controversy.

Here, the controversy which resulted in the decision from which this petition is made was commenced in 1937 by a *summary proceeding* and throughout its whole course the respondent without ever challenging the court's jurisdiction consistently took issue with the trustee in the numerous steps affecting the scope of its mortgage and the rights of the trustee with respect to the chattels which the respondent claimed were affected by its mortgage. While the court's opinion in the *Reading* case does not mention the preliminary all-important objection raised in the court below, the cases cited therein which it followed all show that objections to the jurisdiction were raised when the proceeding was first instituted.

If therefore, no other facts were stated, it quite conclusively appears that an objection to the summary jurisdiction to determine the adverse claim of the respondent was asserted in the *Reading* case at the very inception thereof before the referee; whereas here, the bank and the petitioner both joined in the contest and not until the bank was finally defeated and was pressed to make the estate whole for its improper acts on this motion, did it for the first time object to the jurisdiction of the bankruptcy court to complete its proceedings for the recovery of the value of the trustee's assets which it took and retained throughout the period of litigation.

In a decision of the same court in the case of *Times Square Auto Supply Co., Inc.*, 47 F. (2d) 210, where a bank had, after bankruptcy, appropriated assets of a bankrupt to reimburse it for overdrafts made by the bankrupt before bankruptcy, the court in discussing the power of a bankruptcy court to summarily order the repayment of the moneys, said (p. 212):

> "(The cases) proceed upon the view that property of the bankrupt which is in his possession at the filing of the petition, or comes into his possession thereafter, is constructively in the possession of the bankruptcy court and subject to its summary process; and that any person who takes such property—certainly if he has notice of the pending petition, and probably even if he has not, and pays no present consideration—is likewise subject to a summary order to return it or *to account for its value.*"

Thus we find that whereas the Second Circuit Court of Appeals held in the *Times Square* case that unlawful appropriation of bankrupt property was the subject of summary proceedings to recover its value where the property had been disposed of by the transferee, it disregarded its own opinion in the instant case and held that such a recovery was only by a plenary suit at the instance of the trustee and that the bankruptcy court had no jurisdiction to summarily fix the value of the assets improperly appropriated by the respondent and to direct respondent to account therefor.

The parties are in a court of equity and an examination of its broad powers will undoubtedly show the petitioner to be entitled to the summary relief which he seeks.

Mr. Justice Douglas in the case of *Pepper* v. *Litton*, 308 U. S. 295, 60 Sup. Ct. 238, said:

> "Courts of bankruptcy are constituted by sections 1 and 2 of the bankruptcy act 30 Stat. 544, 11 U. S.

> C. A. sections 1 (8), 11 and by the latter section are invested "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings." Consequently this court has held that for many purposes "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." Local Loan Co. *v.* Hunt, 292 U. S. 234, 240, 54 S. Ct. 695, 697, 78 L. Ed. 1230, 93 A. L. R. 195. By virtue of Sec. 2 a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the act, it applies the principles and rules of equity jurisprudence. (Cites case.)"

Applying this general equitable nature of the bankruptcy court to a specific instance, this Court is referred to the case of *Local Loan Co.* v. *Hunt, supra,* where, in discussing the remedies that a trustee might have, it says:

> "* * * And it may be conceded that the municipal court was authorized in the law action to afford relief the equivalent of that which the respondent now seeks in equity. Nevertheless, other considerations aside, it is clear that the legal remedy thus afforded would be inadequate to meet the requirements of justice. As will be shown in a moment, the sole question at issue is one which the highest court of the state of Illinois had already resolved against respondent's contention. The alternative of invoking the equitable jurisdiction of the bankruptcy court was for respondent to pursue an obviously long and expensive course of litigation, beginning with an intervention in a municipal court and followed by successive appeals through the state intermediate and ultimate Courts of Appeal, before reaching a court whose judgment upon the merits of the question had not been predetermined."

The situation in the last-quoted decision and the circumstances of this case are not dissimilar. Complete equity can be done within the summary jurisdiction of the bank-

ruptcy court, where respondent will be given full opportunity to contest any proof of value offered by petitioner.

Having taken the chattels without legal authority and having used and sold them, respondent says, when asked to pay their value, that because they have been sold the only remedy left to the trustee is to commence a new suit in another forum to recover their value. For that contention we submit there is no moral, legal or equitable basis because respondent having taken property which never belonged to it, should under well established principles of law answer in the court in which every phase of the controversy was litigated for the loss which it brought about so that this bankruptcy estate could be made whole.

It is submitted that the decision of the Circuit Court of Appeals from which this review is sought if left to stand would open the door to the clandestine disposition of assets received from a bankrupt's estate after bankruptcy, leaving the trustee without the expeditious and complete remedy accorded to him by the Bankruptcy Act and compel him to seek out the wrongdoer in a forum lacking the power to give the complete remedy provided by the Bankruptcy Act. It is further submitted that because the decision conflicts with the earlier decision of the same court in the *Times Square Auto Supply* case, with the decision of the Fourth Circuit Court of Appeals in *Commercial Casualty Insurance Co.* v. *Williams*, with that of Judge Grubb *In re Denson* and with *May* v. *Henderson* of this Court, let alone that it is in violation of the spirit and tenor of the Bankruptcy Act, this petition should be granted.

It would be a mockery of justice to first permit the Federal court to determine that title to the chattels was vested in the trustee as of the date when the petition was filed, and then require the trustee to institute a plenary action in another court to recover their value against a proven wrongdoer who admittedly had taken them from the custody of

the bankruptcy court and had made use of and later sold them.

Could the spirit of the Bankruptcy Act be so easily thwarted by interpretations which will require a plenary suit to recover the *res*, or the proceeds thereof if it be sold or the value thereof if it be commingled? And yet the Circuit Court of Appeals has refused to grant the same relief where the property has been taken and sold at a price far below its market value and where the chattels have been put to such continued use as to leave them presently worthless.

Indeed, the question appears to have been a novel one even to the Circuit Court of Appeals, for it said in its opening statement, "This appeal presents an interesting question of summary jurisdiction in bankruptcy." Surely, had the question been settled in the judgment of the court, there would have been no necessity for that statement unless it be that the court overlooked or refused to follow the decisions of the other circuits or misconstrued the decision of this Court in *May* v. *Henderson* by its interpretation thereof in its own previous decision *In re Reading Engineering, Inc.*, upon which it relied in sustaining the District Court in the case at bar.

To deny the relief here sought is to establish a dangerous precedent. An admitted wrongdoer who takes assets from a bankrupt's estate may evade the summary jurisdiction of the bankruptcy court by selling them for little or no consideration, thereby burdening the estate with the expense entailed in prosecuting a plenary action for the purpose of making the estate whole. The respondent never asserted an adverse claim, nor does it dispute petitioner's title to the chattels. It merely claimed a lien under its mortgage which the court overruled. 105 F. (2d) 960. It therefore stands liable to petitioner upon an implied contract to pay for the value of the chattels which it took; and the bankruptcy

court having once taken jurisdiction was vested with power to award final judgment to petitioner for the loss he sustained as a result of the respondent's acts. Whether the taking by the bank was tortious as by conversion or under an implied contract to pay for what it took is, it is submitted, of no importance; and the view of the Circuit Court of Appeals that the taking was of the former nature and for that reason it was beyond the power of the bankruptcy court to accord a remedy was clearly erroneous.

This litigation, as has been stated by the Referee (R. 16) has been in the District Court for over four years, three appeals were taken to the Circuit Court of Appeals and one to the New York Court of Appeals—all in respondent's effort to further an unfounded claim to chattels which represent the sole assets of this estate; and now, after all its efforts have been defeated and nothing remains but to collect from it the loss which this trustee sustained by reason of the depreciation and sale of the assets while they were in the hands of the Bank throughout the numerous legal proceedings, should this trustee be required to commence a new suit in a different forum to collect what this bankruptcy court has adequate authority to give him? It is respectfully submitted that to answer that question in the affirmative would be unjust and would satisfy the cravings of the respondent for endless litigation.

WHEREFORE, it is submitted that for the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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